

DEPARTMENT OF STATE REVENUE

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 97-0476

**Adjusted Gross Income Tax
For Tax Years 1991 through 1993**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Corporate Income Tax—Apportionment Factor Calculations

Authority: 45 IAC 3.1-1-39; 45 IAC 3.1-1-40; 45 IAC 3.1-1-63

Taxpayer protests the numbers used by the Department in determining rental expenses in the property factor of the apportionment formula.

STATEMENT OF FACTS

Taxpayer operates a delivery service. Taxpayer hires independent contractors to pick up packages at customer locations and deliver to locations in Indiana and other states. Independent long-distance haulers provide the transportation link. Those haulers pick up the packages at the terminals and deliver to another terminal. Independent intercity drivers make subsequent deliveries. Taxpayer protests the numbers used by the Department in determining rental expenses in the property factor of the apportionment formula for its Indiana Adjusted Gross Income Tax returns.

I. Corporate Income Tax—Apportionment Factor Calculations

DISCUSSION

Taxpayer protests assessments made by the Department of Revenue on taxpayer's 1991, 1992 and 1993 corporate income taxes. The disagreement involves the Department's estimation of the portion of rental payments to independent truck drivers which was apportioned to truck rental as opposed to driver salary. The Department allocated eighty percent (80%) of the rental payments to truck rental and twenty percent (20%) to driver salary. Taxpayer believes that the portion of rental payments allocated to truck rental are significantly lower than eighty percent.

The original Letter of Findings explained that taxpayer did not separate rental payments into labor costs and equipment costs. In order to establish the property factor for the apportionment formula for the tax years in question, the Department assigned eighty percent (80%) of the rental costs towards equipment rental payments. At the original hearing, taxpayer claimed that this percentage was not accurate, but failed to present any documentation supporting that assertion. At rehearing, taxpayer provided sufficient documentation to establish that the portion of rental payments allocated towards rented equipment was lower than originally set. The information supplied by taxpayer at rehearing will be provided to the Audit division of the Department of Revenue for review.

Taxpayer also asserts that the Department is unfairly treating transportation companies differently than it treats other companies doing business in multiple states. Taxpayer believes that the Department does not treat other businesses involved in multiple states the same way it treats transportation companies. The Department follows 45 IAC 3.1-1-63. That regulation has a subsection titled "Transportation Companies", which states in pertinent part:

IC 6-3-2-2(b) requires that interstate carriers and all other multistate taxpayers use the three-factor formula in apportioning their business income. This method will assure consistency in the application of the Adjusted Gross Income Tax Act to multistate carriers. Business income for transportation companies is apportioned to Indiana by use of the following formula:

$$\frac{\text{Tangible property} + \text{payroll} + \text{revenue from transportation}}{3}$$

45 IAC 3.1-1-63(A) explains the tangible property factor:

Tangible Property. Fixed properties such as buildings and land used in business, shop and terminal equipment and trucks or cars used locally or any tangible property connected with the transportation business, will be assigned to the state in which such properties are located. The value of all moveable equipment used in interstate transportation will be assigned to this State on the basis of total miles traveled in this State, as compared to total miles everywhere. Fixed and moveable property will then be combined to arrive at the total property factor, Indiana property over property everywhere.

Property owned by the transportation company is valued at original cost. Property rented is valued at eight (8) times the annual rental rate less any annual subrental.

The standard apportionment formula, as described in 45 IAC 3.1-1-39, is:

$$\text{Business income} \times \frac{\text{property factor} + \text{payroll factor} + \text{sales factor}}{3}$$

In describing the property factor mentioned in 45 IAC 3.1-1-39, 45 IAC 3.1-1-40 explains in part:

Property Factor. The property factor is a fraction, the numerator of which is the average value of the taxpayer's Indiana property, and the denominator of which is the total value of the taxpayer's property everywhere. As used in this regulation [45 IAC 3.1-1-40], the word "property" includes all real and tangible personal property of the taxpayer, whether owned or rented, which is or could be used to produce business income during the tax period. This includes land, buildings, machinery, inventory, equipment and any real or tangible personal property used to produce business income, but not coin, currency or intangibles.

Put simply, the Department determines the apportionment percentage for non-transportation companies by adding the tangible personal property factor to the payroll factor and the sales factor, and then dividing by three for 1991 and 1992, and 3.33 for 1993. The Department determines the apportionment percentage for transportation companies by adding the tangible personal property factor to the payroll factor and the sales factor, and then dividing by three for 1991 and 1992, and 3.33 for 1993. The Department is not convinced that its treatment of transportation companies is unfair.

Next, taxpayer states that the truck owners are free to pick up other trailers on their return trip, and that the trucks are therefore not under taxpayer's control one hundred percent of the time. The Department's assessment is not based on the percentage of time the taxpayer controls the trucks. Rather, the assessment is based on the amount taxpayer pays to rent the trucks. The duration of that rental period is not relevant. The fact that others may rent the equipment when taxpayer is not renting it is not relevant.

Taxpayer states that Indiana does not attempt to tax "purchased transportation", but only "owned or rented" assets. Taxpayer refers to MTC model regulation IV.18(g) (1986) which the Department used as a base for its assignment of 80% of rental costs towards equipment rental. Taxpayer confuses the application of 45 IAC 3.1-1-63, which provided for the inclusion of rented property in the property factor of the apportionment formula, with the application of MTC model IV.18(g) (1986), which provided the model for the method to determine the percentage of rental costs to be included in the property factor.

The Department did not base its assessment on MTC model IV.18(g). 45 IAC 3.1-1-63 authorizes the inclusion of rented property in the apportionment formula. The referral to MTC model IV.18(g) was not for authorization. Rather, the referral was to help determine a method to separate equipment rental costs from labor costs in the absence of such a separation by the taxpayer.

Taxpayer states three government agencies have all concluded the arrangement between taxpayer and the owner-operators is that of true independent contractors. Taxpayer also states that these agencies use common law tests rather than statutory tests and that, absent statutory authority to the contrary, Indiana should view the relationship under the common law test. Taxpayer believes that the owner-operators are providing a service to taxpayer and therefore none of the tangible personal property used by the owner-operators should be viewed as “owned or rented” property in taxpayer’s property factor.

Taxpayer offers no citation explaining why tangible personal property used by owner-operators, even if those owner-operators are independent contractors, should not be included in taxpayer’s property factor for Adjusted Gross Income Tax. As explained in 45 IAC 3.1-1-63(A), rented property is included in the tangible property factor. Taxpayer’s assertion that the equipment should not be included in the tangible personal property factor is insufficient.

In conclusion, taxpayer has provided sufficient documentation to show that the portion of the rental payments it made to owner-operators is lower than the original estimate. The rented equipment was properly included in the tangible personal property factor for the apportionment formula. The file will be returned to the Audit Division for recalculation of the tangible property factor of the apportionment formula.

FINDING

Taxpayer’s protest is sustained in part and denied in part. Taxpayer’s protest is sustained to the extent that it has established the percentage of the payments allocated towards renting equipment is lower than originally set. Taxpayer’s protest is denied to the extent that the rented equipment was properly included in the apportionment factor.